No. 02-458

# In the Supreme Court of the United States

RAYMOND B. YATES, M.D., P.C. PROFIT SHARING PLAN, AND RAYMOND B. YATES, TRUSTEE, PETITIONERS

*v.*

WILLIAM T. HENDON, TRUSTEE

*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS


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## QUESTION PRESENTED

Whether the working owner of a business (here, the sole shareholder of a corporate employer) is precluded from being a "participant" under Section 3(7) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1002(7), in an ERISA plan.

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## INTEREST OF THE UNITED STATES

This case presents the question whether a working owner (such as a shareholder, sole proprietor, or partner who renders services to a business) may be a participant in a plan covered by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1001 *et seq.* Three agencies of the United States—the Department of Labor, the Department of the Treasury, and the Pension Benefit Guaranty Corporation (PBGC)—share responsibility for administering and enforcing ERISA. The Secretary of Labor is primarily responsible for interpretation and enforcement of Title I of ERISA, 29 U.S.C. 1001 *et seq.* The Secretary of the Treasury is responsible for interpretation and enforcement of Title II of ERISA, 88 Stat. 898 (codified in various provisions of Title 26 of the United States Code). And the PBGC

is responsible for interpreting and enforcing the provisions of Title IV of ERISA, 29 U.S.C. 1301 *et seq.* The question presented concerns the definition and coverage provisions of Title I of ERISA, but the question of who may participate in an ERISA plan arises under each title of ERISA. The United States therefore has a substantial interest in the question presented. The United States filed an amicus brief at the petition stage in response to the Court's order inviting the Solicitor General to express the views of the United States.

## STATEMENT

1. Congress enacted ERISA "to protect * * * the interests of participants in employee benefit plans and their beneficiaries." 29 U.S.C. 1001(b). Title I of ERISA (29 U.S.C. 1001 *et seq.*) contains provisions, administered and enforced primarily by the Department of Labor, that govern reporting and disclosure, fiduciary responsibility, and plan administration and enforcement, as well as substantive requirements for pension and group health plans. Title II, 88 Stat. 898 (codified in various provisions of Title 26 of the United States Code), contains amendments to Internal Revenue Code provisions establishing the conditions that employee benefit plans must meet to qualify for favorable tax treatment. Title III (29 U.S.C. 1201 *et seq.*) contains miscellaneous administrative provisions, and Title IV (29 U.S.C. 1301 *et seq.*) establishes the PBGC to guarantee benefits to participants in and beneficiaries of defined benefit pension plans.

Title I defines a "participant" as "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible

to receive any such benefit." 29 U.S.C. 1002(7). Title I defines an "employee" as "any individual employed by an employer." 29 U.S.C. 1002(6). Title I defines a "beneficiary" as "a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." 29 U.S.C. 1002(8). Participants and beneficiaries are authorized to bring civil actions to enforce their rights under ERISA and ERISA plans. 29 U.S.C. 1132(a)(1)(B), (2), and (3).[1]

2. Dr. Raymond B. Yates was a practicing physician and the sole shareholder and president of a professional corporation known as Raymond B. Yates, M.D., P.C. Pet. App. 2a, 10a. The corporation maintained the Raymond B. Yates, M.D., P.C. Profit Sharing Plan (the plan), of which Dr. Yates was the plan administrator and trustee. *Id.* at 2a-3a. As of June 30, 1996, four persons were designated as plan participants, including Dr. Yates. *Id.* at 3a. From its inception, the plan always had at least one participant other than Dr. Yates and his wife. See *id.* at 10a.

The plan qualified for favorable tax treatment under Section 401 of the Internal Revenue Code (the Code), 26 U.S.C. 401, as amended by ERISA, see Pet. App. 2a-3a, and contained an anti-alienation provision as required both by the Code, 26 U.S.C. 401(a)(13), and by Title I of ERISA, 29 U.S.C. 1056(d). Pet. App. 4a. That provision, entitled "Spendthrift Clause," provided in relevant part:

> Except for Plan loans to Participants as permitted by ARTICLE 12 and the assignments provided therefor, no benefit or interest available hereunder will be subject to assignment or alienation, either voluntarily or involuntarily.

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[1] Plan fiduciaries and the Secretary of Labor are also authorized to bring civil actions to enforce Title I of ERISA. See 29 U.S.C. 1132(a)(2), (3), and (5).

*Id.* at 11a. Article 12 of the plan, which authorized participant loans, also imposed various requirements specified by Title I of ERISA and the Code, including that the loan be adequately secured by the participant's accrued benefit, that the loan bear a reasonable rate of interest, and that the participant make repayments at least quarterly over a period not to exceed five years. C.A. App. 235-236; see 29 U.S.C. 1056(d)(2), 1108(b)(1); 26 U.S.C. 72(p)(2)(B) and (C), 401(a)(13)(A), 4975(d)(1).

In December 1989, Dr. Yates borrowed $20,000 from the plan at 11% interest and pledged as security his vested account balance in the plan. Pet. App. 3a, 10a-11a. The initial term of the loan was five years, but the loan was extended for another five years in June 1992. *Id.* at 3a. Although the loan agreement required monthly payments of $433.85, Dr. Yates made no payments until November 1996, when he repaid the entire principal and interest due in two payments that totaled $50,467.46. *Id.* at 3a, 11a. On December 2, 1996, three weeks after the repayment, Dr. Yates' creditors filed an involuntary bankruptcy petition against him under Chapter 7 of the Bankruptcy Code (11 U.S.C. 701 *et seq.*). Pet. App. 3a; see 11 U.S.C. 303.

3. Several months later, respondent William T. Hendon, the trustee in bankruptcy, commenced this adversary proceeding under 11 U.S.C. 547(b) and 550 against the plan and Dr. Yates as plan trustee (petitioners herein) in the United States Bankruptcy Court for the Eastern District of Tennessee. Respondent asked the court to set aside the loan repayment as a preferential transfer, avoidable under Section 547, and to order the plan to pay respondent the money that Dr. Yates had repaid the plan. Pet. App. 3a. Both parties filed motions for summary judgment, and the court granted summary judgment to respondent. *Id.* at 36a-50a.

The bankruptcy court first held that the loan repayment met the criteria for a preferential transfer under Section

547(b). Pet. App. 41a-42a. The court then considered and rejected petitioners' argument that respondent could not recover the preferential transfer because the plan contained an anti-alienation provision enforceable under ERISA. *Id.* at 43a-44a, 46a-47a.

Section 541(c)(2) of the Bankruptcy Code provides that a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under [the Bankruptcy Code]." 11 U.S.C. 541(c)(2). In *Patterson* v. *Shumate*, 504 U.S. 753 (1992), this Court held that the anti-alienation provision of ERISA is "applicable nonbankruptcy law" within the meaning of Section 541(c)(2) and that a debtor's interest in an ERISA plan is therefore excluded from the debtor's bankruptcy estate. 504 U.S. at 757-765. Based on *Patterson* and Section 541(c)(2), petitioners argued that Dr. Yates' interest in the plan, including the amount of his loan repayment, was excluded from his bankruptcy estate.

The bankruptcy court rejected that argument. The court reasoned that Dr. Yates, as the "self-employed owner of the professional corporation that sponsors the pension plan," "cannot participate as an employee under ERISA and he cannot use its provisions to enforce the restriction on the transfer of his beneficial interest" in the plan. Pet. App. 43a-44a (citing *SEC* v. *Johnston*, 143 F.3d 260 (6th Cir. 1998); *Fugarino* v. *Hartford Life & Accident Ins. Co.*, 969 F.2d 178 (6th Cir. 1992), cert. denied, 507 U.S. 966 (1993); and 29 C.F.R. 2510.3-3(c)(1)). The court therefore concluded that Dr. Yates' interest in the plan was not protected by ERISA and not excluded from his bankruptcy estate under Section 541(c)(2). See Pet. App. 46a.[2]

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[2] Because the bankruptcy court concluded that Dr. Yates' interest in the plan was not excluded from his bankruptcy estate, the court found it

4. The United States District Court for the Eastern District of Tennessee affirmed the judgment of the bankruptcy court. Pet. App. 9a-35a. The district court considered itself bound by prior Sixth Circuit decisions that had held that neither a sole proprietor, *Fugarino*, *supra*, nor a sole shareholder of a corporate employer, *Agrawal* v. *Paul Revere Life Insurance Co.*, 205 F.3d 297 (2000), may be a participant in an ERISA plan. Pet. App. 16a-21a.

Those decisions relied in significant part on a Department of Labor regulation, 29 C.F.R. 2510.3-3(c)(1), which the decisions interpreted to exclude sole owners and their spouses from the definition of "employee" for purposes of Title I of ERISA, and therefore also from the definition of a plan "participant." See 29 U.S.C. 1002(6) (defining "employee" as "any individual employed by an employer"); 29 U.S.C. 1002(7) (defining "participant" as an "employee or former employee * * * who is or may become eligible to receive a benefit of any type from an employee benefit plan"). The district court acknowledged that the regulation is better read to address only which plans are covered by Title I of ERISA, and to permit sole owners to participate in ERISA plans that also include other employees, as other circuits have held. Pet. App. 19a (citing *Madonia* v. *Blue Cross & Blue Shield*, 11 F.3d 444 (4th Cir. 1993), cert. denied, 511 U.S. 1019 (1994), and *Vega* v. *National Life Ins. Servs., Inc.*, 188 F.3d 287 (5th Cir. 1999)). The court concluded, however, that it was bound by Sixth Circuit precedent, under which Dr. Yates "was not qualified to participate in an ERISA protected plan." *Id.* at 20a. Because Dr. Yates could not be a participant in an ERISA plan, the court concluded that none

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unnecessary to decide whether a bankruptcy trustee may avoid and recover a preferential transfer from property that is excluded from the estate. Pet. App. 47a.

of his interest in the plan, including the amount he returned in the loan repayments, was protected by ERISA. *Ibid.*[3]

5. The United States Court of Appeals for the Sixth Circuit affirmed the district court's judgment. Pet. App. 1a-8a. The court of appeals reasoned that the plan's anti-alienation clause is not "enforceable under applicable nonbankruptcy law" within the meaning of 11 U.S.C. 541(c)(2) because it "is not enforceable by Dr. Yates under ERISA." Pet. App. 6a.

The court of appeals noted that ERISA provides that "[a] civil action may be brought . . . by a participant, beneficiary, or fiduciary . . . to obtain . . . appropriate equitable relief . . . to enforce . . . the terms of the plan." Pet. App. 5a (quoting 29 U.S.C. 1132(a)(3)(B)(ii)). But the court reasoned that, under *Fugarino* and *Agrawal*, Dr. Yates, as a sole shareholder, "cannot qualify as a 'participant or beneficiary' in an ERISA pension plan." *Ibid.* Concluding that those circuit precedents dictate that Dr. Yates "does not have standing under the ERISA enforcement mechanisms," *ibid.* (quoting *Agrawal*, 205 F.3d at 302), the court held that "the spendthrift clause in the * * * plan is not enforceable by Dr. Yates under ERISA." *Id.* at 6a.

The full court subsequently denied a petition for rehearing en banc. Pet. App. 51a.

## SUMMARY OF ARGUMENT

Many shareholders, sole proprietors, and partners render services to the businesses they own in exchange for remuneration. This case presents the question whether those working owners may be participants in plans covered by ERISA, 29 U.S.C. 1001 *et seq.* The analytic framework for answering that question is described in this Court's decision

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[3] The district court, like the bankruptcy court, therefore did not decide whether, "had Dr. Yates been eligible to participate in the Plan under ERISA, the Chapter 7 Trustee might have been prohibited from avoiding Dr. Yates's loan repayments to the Plan." Pet. App. 22a.

in *Nationwide Mutual Insurance Co.* v. *Darden*, 503 U.S. 318 (1992), which addressed ERISA coverage of independent contractors. Because the statutory definitions of "employee" and "participant" are unhelpful, the Court first looks to other provisions of ERISA for specific guidance on the coverage question. If that quest also fails, the Court looks to common-law principles (as it did in *Darden*), unless doing so would thwart the congressional design or lead to irrational results.

In the case of working owners (unlike independent contractors), there is no cause to resort to the common law because Title I of ERISA and related provisions of law clearly indicate that Congress intended to permit working owners to be plan participants. Title I itself contains several partial exemptions from ERISA requirements for plans in which working owners participate. Those exemptions would be largely unnecessary if working owners were categorically excluded from participation in ERISA plans. Title I also cross-references a number of Internal Revenue Code provisions that plainly contemplate the participation of working owners in tax-qualified pension plans. Title IV of ERISA likewise contains a number of provisions that assume working owners may be plan participants. Thus, all of ERISA reflects the basic premise that working owners may participate in ERISA plans. That is not surprising, because ERISA was enacted against the backdrop of Internal Revenue Code provisions that have long allowed corporate shareholders, partners, and sole proprietors to participate in tax-qualified pension plans.

Allowing working owners to be participants in benefit plans covered by ERISA furthers ERISA's purposes of promoting employee benefit plans and protecting the interests of plan participants and their beneficiaries. Working owners who participate in plans on an equal basis with other employees may benefit from the fiduciary protections provided by Title I of ERISA, as well as the tax preferences provided

by Title II, and the termination insurance provided by Title IV. At the same time, allowing working owners to be plan participants encourages them to create plans that also provide benefits to other employees and promotes economies of scale in plan administration and investments.

Excluding working owners from the definition of plan "participant" would lead to irrational consequences in the administration of employee benefit plans. First, it would create different and unequal rights and remedies for working owners and other employees who are covered by the same plan, such as an insured group health plan or a multiemployer pension plan. Second, splitting a plan into ERISA and non-ERISA components would be administratively unworkable under both the Internal Revenue Code and Title I of ERISA. For example, a pension plan must be either tax-qualified or not; it cannot be tax-qualified in part. Similarly, many fiduciary duties run to the plan as a whole. In a traditional defined benefit plan, for instance, such duties could not attach only to plan assets earmarked for certain employees because plan assets are not segregated into individual accounts.

Treating working owners as ERISA "beneficiaries" rather than "participants," as some courts have done, does not solve those problems. The "beneficiary" approach has no logical stopping point, because it would allow a plan to cover anyone it chooses, including independent contractors excluded by *Darden*. The "beneficiary" approach also fails to resolve participation questions for pension plans which, unlike welfare plans, tie coverage directly to service as an employee. In contrast, the anomalous results are avoided if ERISA is read to allow working owners to be participants in ERISA plans.

Based on the foregoing considerations, the Department of Labor (DOL), which is responsible for interpreting the definition and coverage provisions of Title I of ERISA, has

issued an advisory opinion interpreting ERISA to permit working owners to be participants in ERISA plans. A DOL regulation (which the court below misconstrued) says nothing to the contrary. Nor does permitting participation by working owners run afoul of the provision of ERISA that prevents plan assets from inuring to the benefit of employers. That provision expressly permits the payment of benefits to plan participants and does not address who is eligible to be a plan participant.

## ARGUMENT

### A WORKING OWNER MAY BE A "PARTICIPANT" IN AN ERISA PLAN

Millions of Americans not only own businesses but also work for the businesses that they own.[4] Hundreds of thousands of those working owners are covered, along with the other employees of their businesses, by pension or other benefit plans.[5] The question presented by this case is

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[4] Over 10 million workers are self-employed in unincorporated businesses. Bureau of Labor Statistics, U.S. Dep't of Labor, 50 *Employment & Earnings* No. 5, Tab. A7, at 16 (May 2003). Approximately four million additional workers are self-employed as wage and salary workers in incorporated businesses. Bureau of the Census, U.S. Dep't of Commerce, *Current Population Survey, February 2001: Contingent Work Supplement* (unpublished data file tabulated by U.S. Dep't of Labor).

[5] Labor Department statistics indicate that, in 1998, there were 313,370 pension plans covered by Title I of ERISA with two to nine participants, and 298,422 covered plans with 10 to 99 participants. Pension & Welfare Benefits Admin., U.S. Dep't of Labor, *Private Pension Plan Bulletin, Abstract of 1998 Form 5500 Annual Reports*, No. 11, Tab. B1, at 13 (Winter 2001-2002). Although those statistics do not indicate how many participants are working owners, the Department believes, based on its experience, that, on average, each of those plans includes at least one working owner. That estimate is consistent with household survey data collected by the Census Bureau, which indicate that more than one million self-employed workers were participants in some kind of pension plan in 1998 (although not all those plans are covered by Title I of ERISA). Bureau of the Census, U.S. Dep't of Commerce, *Survey of Income and*

whether those working owners are "participant[s]" in their benefit plans within the meaning of Title I of ERISA, 29 U.S.C. 1002(7), and thus enjoy the protections that ERISA provides and are governed by the rights and remedies that it specifies. As the Department of Labor has explained in an advisory opinion letter, a working owner may be a "participant" in an ERISA plan. See Pension & Welfare Benefits Admin., U.S. Dep't of Labor, Advisory Opinion No. 99-04A (Feb. 4, 1999) (*reprinted in* App., *infra*, 1a-9a). That conclusion is supported by this Court's precedent, the text of ERISA, and the historical context in which ERISA was enacted, and it furthers ERISA's underlying purposes.

### A. Under *Nationwide Mutual Insurance Co.* v. *Darden*, Whether A Working Owner May Be A Participant In An ERISA Plan Turns On The Text Of ERISA

This Court's decision in *Nationwide Mutual Insurance Co.* v. *Darden*, 503 U.S. 318 (1992), sets forth the appropriate framework for analyzing whether a working owner can be a "participant" in an ERISA plan. In *Darden*, the Court addressed whether an insurance salesman was a "participant," within the meaning of Section 3(7) of ERISA, 29 U.S.C. 1002(7), in a retirement plan sponsored by the insurance company whose policies the agent sold. The Court explained that an individual generally can qualify as an ERISA plan "participant" only if the individual is an "employee," which ERISA defines as "any individual employed by an employer." 503 U.S. at 320-321 (quoting 29 U.S.C. 1002(6) and (7)). The Court found the definition of "employee" to be "completely circular," so it looked elsewhere to determine whether the salesman was an "employee" or was instead an independent contractor. *Id.* at 323. Because the Court could not find "any provision [in ERISA] either giving specific

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*Program Participation, 1996 Panel, Wave 7, Pension Benefits Module* (unpublished data file tabulated by U.S. Dep't of Labor).

guidance" on how to differentiate between an employee and an independent contractor or suggesting that adopting the traditional common-law test to distinguish between the two categories "would thwart the congressional design or lead to absurd results," the Court adopted the common-law test. *Ibid.*

The precise question in *Darden* was different from the question presented here. The question in *Darden* was whether someone who provides services to a business in exchange for remuneration is precluded from being a "participant" in an ERISA plan because he is an independent contractor. Here, the question is whether someone who provides services to a business in exchange for remuneration is precluded from being a "participant" because he is the business's owner. Nonetheless, *Darden* sets forth the appropriate mode of analysis for resolving the question presented here.

As the Court explained in *Darden*, ERISA's definition of "employee," which is in turn part of the definition of "participant," is "completely circular." 503 U.S. at 323. Thus, just as the definitions of "employee" and "participant" were not helpful in resolving the question in *Darden*, they are not helpful in resolving the question whether a working owner may be an ERISA plan participant. The first step in resolving that question, under *Darden*, is to determine whether any other provisions of ERISA furnish guidance. See *ibid.* If other statutory provisions also provided no guidance, then the second step would be to use common-law principles to resolve the question, provided their application would not thwart the congressional design or lead to irrational consequences. *Ibid.*

The Court recently followed that mode of analysis in *Clackamas Gastroenterology Assocs., P.C.* v. *Wells*, 123 S. Ct. 1673 (2003), which presented the question whether a working owner (there, a major shareholder of a professional

corporation) was an employee within the meaning of the Americans With Disabilities Act of 1990 (ADA), 42 U.S.C. 12101 *et seq*. The text of the ADA provided no guidance on the coverage of working owners. See 123 S. Ct. at 1677. Accordingly, the Court endorsed the test developed by the Equal Employment Opportunity Commission (EEOC) for resolving the question. That test, which was drawn from common-law principles, focused on the extent of the corporation's control over the shareholder. *Id.* at 1678-1681.[6]

In this case, unlike in *Clackamas*, there is no need to proceed to the second step of the *Darden* analysis and to develop a test based on common-law distinctions between master and servant. The question is resolved at the first step of the analysis because, unlike the ADA, ERISA is not silent on the coverage of working owners. As explained below, the text of ERISA, and the longstanding Internal Reve-

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[6] The EEOC control test does not precisely mirror the common law; rather, it looks to the common law only as "helpful guidance." *Clackamas*, 123 S. Ct. at 1679; Tr. of Oral Arg. at 17-18, *Clackamas*, *supra* (No. 01-1435). The EEOC test also reflects the ADA's purpose of eliminating discrimination while not unnecessarily burdening small businesses. See Br. for United States et al. as Amicus Curiae at 10-11, *Clackamas*, *supra* (No. 01-1435); 123 S. Ct. at 1678-1679 & n.6. As explained in the text following this note, resort to common-law principles (even for guidance) is not appropriate in resolving whether working owners may be participants in ERISA plans because the text of ERISA itself resolves that question. Even if the Court were to consult the common law, however, it should also consider the purposes of ERISA, just as the EEOC and the Court considered the purposes of the ADA in *Clackamas*. Because the purposes of ERISA differ from those underlying the ADA and other anti-discrimination statutes, a test that focuses on the extent of the business's control over the working owner is not appropriate to resolve the ERISA coverage question. Although a controlling shareholder of a corporation may not need statutory protection from discrimination (and indeed may be part of the management that is responsible for such discrimination), there are good reasons to permit controlling shareholders to participate along with other employees in benefit plans protected by ERISA. See pp. 20-25, *infra*.

nue Code provisions that provided the backdrop for its enactment, establish that Congress intended that working owners of all types may be participants in ERISA plans.[7]

### B. The Text Of ERISA Demonstrates That A Working Owner May Be A Participant In An ERISA Plan

1. A variety of provisions in ERISA make clear that working owners may be "participants" in employee benefit plans covered by ERISA. Most notably, several provisions of Title I specifically address working owners by providing partial exemptions from certain ERISA requirements for plans in which working owners are participants. Those partial exemptions would be largely unnecessary if working owners were categorically excluded from participation.

For example, Title I of ERISA imposes a variety of "fiduciary responsibility" requirements, which are designed to ensure that ERISA plans will be managed responsibly and for the benefit of plan participants and their beneficiaries. See 29 U.S.C. 1101 *et seq.* There are exemptions from the fiduciary responsibility requirements for certain plans involving working owners. In particular, a plan is exempt from the fiduciary responsibility requirements if it "is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." 29 U.S.C. 1101(a)(1). Such plans are quite likely to include working owners as participants, because a "highly compensated employee" is defined, by Internal Revenue Code

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[7] Consistent with that understanding, the parties before the Court in *Clackamas* agreed that shareholder-employees are "employees" and thus "participants" under ERISA. See Tr. of Oral Arg. at 6-7, *Clackamas*, *supra* (No. 01-1435) (concession by counsel for petitioner, who argued that shareholder-employees are not employees under the ADA, that they are employees under ERISA). The dissent in *Clackamas* noted the point, see 123 S. Ct. at 1682 (Ginsburg, J., dissenting), although the majority did not refer to it.

(Code) provisions relating to ERISA plans, as "any employee" who owns more than five percent of the stock of a corporate employer or more than a five percent interest in a non-corporate employer. 26 U.S.C. 414(q)(1)(A) and (2), 416(i)(1)(B)(i). Also exempt from the fiduciary responsibility requirements is "any agreement described in section 736 of [the Code], which provides payments to a retired partner or deceased partner or a deceased partner's successor in interest." 29 U.S.C. 1101(a)(2). Such arrangements necessarily involve plans in which partners are participants. See 26 U.S.C. 736. The two exemptions from the fiduciary responsibility requirements—particularly the latter—thus presuppose that working owners may participate in plans covered by Title I of ERISA.

There are also more limited exemptions from particular fiduciary responsibility requirements for certain plans in which working owners are "participants." For example, all assets in ERISA-covered plans must generally be held in trust. 29 U.S.C. 1103(a). But 29 U.S.C. 1103(b)(3)(A) exempts from that requirement, subject to certain qualifications, a plan "some or all of the *participants* of which are *employees* described in section 401(c)(1) of [the Code]" (emphasis added). Section 401(c)(1) provides that the term "employee," for purposes of Section 401 (which prescribes the criteria under which pension plans qualify for favorable tax treatment), includes a "self-employed individual." 26 U.S.C. 401(c)(1)(A). That term is in turn defined as a person with "earned income" from "a trade or business in which personal services of the taxpayer are a material income-producing factor," a definition that includes working sole proprietors and partners. See 26 U.S.C. 401(c)(1)(B) and (2)(A)(i), 1402(a) and (c). The exemption from the trust requirement provided by Section 1103(b)(3)(A) would be unnecessary if a working partner or sole proprietor could not be a "participant" in an ERISA plan.

Exemptions from ERISA's prohibited transaction provisions also indicate that working owners may be plan participants. ERISA generally prohibits transactions between a plan and a party in interest, 29 U.S.C. 1106, but contains an exemption for loans to plan participants that meet certain conditions. One condition is that the loans not discriminate in favor of "highly compensated employees (within the meaning of section 414(q) of [the Code])." See 29 U.S.C. 1108(b)(1)(B). As noted above, "highly compensated employees" are frequently working owners, including shareholder-employees. Furthermore, 29 U.S.C. 1108(d)(1) excludes from the participant loan exemption an "owner-employee" as defined in Section 401(c)(3) of the Internal Revenue Code. An "owner-employee" means an employee who is either a sole proprietor or a partner who owns more than 10% of the partnership. 26 U.S.C. 401(c)(3). Thus, the participant loan provisions assume that shareholders, sole proprietors, and partners may be participants in plans covered by Title I of ERISA.

2. That reading of Title I of ERISA is reinforced by related statutory provisions. As the above discussion illustrates, various provisions of the Internal Revenue Code, cross-referenced in Title I of ERISA, make clear that working owners may be participants in employee benefit plans that qualify for favorable tax treatment. A pension plan may qualify for favorable tax treatment only if it is "for the exclusive benefit of * * * employees." 26 U.S.C. 401(a). The Code expressly provides that "employees" eligible to receive benefits under tax-qualified pension plans include "self-employed individuals," such as "owner-employees," 26 U.S.C. 401(c), a group which, as described above, encompasses working sole proprietors and partners. Internal Revenue Service (IRS) regulations also expressly provide that the "employees" that may be benefitted by tax-qualified plans include "officers and shareholders." 26 C.F.R. 1.401-

1(b)(3). And an IRS Revenue Ruling, in turn, makes clear that a participant shareholder may be a "principal or sole shareholder." Rev. Rul. 72-4, 1972-1 C.B. 105. The Code assumes that the corporation is the employer of a working shareholder and specifically provides that a sole proprietor "shall be treated as his own employer," and "[a] partnership shall be treated as the employer of each partner" who has earned income from the partnership. 26 U.S.C. 401(c)(4).

Similarly, the plan termination insurance provisions in Title IV of ERISA expressly contemplate participation by working owners in plans covered by its provisions. Title IV generally applies to any employee pension benefit plan, as defined in 29 U.S.C. 1002(2), that is not an individual account plan and that meets specified requirements in the Internal Revenue Code, including qualification under Section 401(a). 29 U.S.C. 1321. Title IV excepts from its coverage any plan "established and maintained exclusively for substantial owners," 29 U.S.C. 1321(b)(9), which include sole proprietors, and partners and shareholders with an ownership interest of more than 10%, 29 U.S.C. 1322(b)(5)(A). Plans in which substantial owners participate along with other employees are, however, generally covered by Title IV. See 29 U.S.C. 1322(b)(5)(B) (limiting amount of benefits that PBGC will guarantee to substantial owners who participate in single-employer plans).[8]

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[8] Title IV also excepts from its coverage plans with 25 or fewer active participants that are "established and maintained by a professional service employer." 29 U.S.C. 1321(b)(13). A "professional service employer" includes "any proprietorship, partnership, corporation, or other association or organization * * * owned or controlled by professional[s] * * * the principal business of which is the performance of professional services." 29 U.S.C. 1321(c)(2)(A). A "professional service employer" thus includes a professional corporation of the type involved in this case. Inclusion of the express exception for certain plans established by professional service corporations demonstrates that such plans, in which

Another indication that working owners may be participants in plans covered by Title IV of ERISA is that Title IV, like the Internal Revenue Code, contains a provision identifying the "employer" of sole proprietors and partners. See 29 U.S.C. 1301(b)(1) (providing that a sole proprietor "is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of section 401(c)(1)" of the Code). That provision (like the similar Code provision) makes clear that, under ERISA, a working owner may properly have a dual status, in which he is both an employee entitled to participate in an ERISA plan and the employer (or owner or member of the employer) who establishes the plan. Accordingly, where a working owner becomes a member of an ERISA plan on a basis equal to other employees, he has assumed the status of those employees for purposes of ERISA and is properly treated as a participant in the plan. In sum, ERISA reveals a clear congressional design, evident throughout all of its substantive titles, that working owners may be participants in ERISA-covered employee benefit plans.[9]

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shareholder-employees who perform professional services are likely to be participants, are generally covered by Title IV.

[9] Although all three of ERISA's substantive titles contemplate that working owners may be participants in covered plans, a particular plan may (by statute or by regulation) be covered by one title of ERISA and not another, and whether a plan is covered under a particular title may depend on the extent to which working owners are participants. For example, if Dr. Yates owned a small corporation that employed only him and his spouse, a pension plan covering them would be excluded from Title I by 29 C.F.R. 2510.3-3, tax-qualified under 26 U.S.C. 401, as amended by Title II, and excluded from Title IV under 29 U.S.C. 1321(b)(9) and (13). In contrast, if Dr. Yates owned a larger corporation with 30 employees, all of whom were participants in a defined benefit pension plan in which he also participated, the plan would be covered by all three titles of ERISA. But those differences concern whether a particular plan is covered under a particular title; they do not concern whether working owners may be

### C. ERISA Was Enacted Against The Backdrop Of Internal Revenue Code Provisions That Have Long Permitted Working Owners To Participate In Tax-Qualified Employee Benefit Plans

The historical context in which Congress enacted ERISA reinforces the textual provisions demonstrating that working owners are eligible to participate in ERISA plans. ERISA was not the first federal legislation to address employee benefit plans. Tax laws concerning such plans had been in place for decades before ERISA was enacted. In enacting ERISA, Congress sought to integrate the new legislation with those existing tax provisions. Significantly, the tax laws concerning employee benefit plans that formed the backdrop for ERISA's enactment had long permitted working owners to participate in plans qualifying for favorable tax treatment.

Shareholders who work for the corporations in which they own stock have been treated as "employees" eligible to participate in tax-qualified pension plans since 1942. Under the Revenue Act of 1942, a pension trust was tax-exempt if, among other things, "the contributions or benefits provided under the plan [did] not discriminate in favor of *employees who [were]* officers, *shareholders*, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees." Revenue Act of 1942, ch. 619, § 162, 56 Stat. 862 (formerly codified at 26 U.S.C. 165(a)(4) (1946)) (emphasis added). See S. Rep. No. 992, 87th Cong., 1st Sess. 8-9 (1961).

In 1962, Congress enacted the Self-Employed Individuals Tax Retirement Act, Pub. L. No. 87-792, 76 Stat. 809, authorizing the creation of tax-favored "H.R. 10" or "Keogh" plans for partners and sole proprietors. The Senate Report

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participants in covered plans. The different titles give a uniform and affirmative answer to the latter question.

accompanying the legislation explained that Congress sought to give "self-employed persons access to retirement plans on a reasonably similar basis to that accorded corporate stockholder employees." S. Rep. No. 992, *supra*, at 8. Among other things, the 1962 Act added the current provisions in 26 U.S.C. 401(c) and (d), discussed earlier, which define the term "employee" to include persons with earned income from self-employment, and define the term "owner-employee" to include working sole proprietors and certain working partners. 76 Stat. 811-815.

Thus, by 1962, all three types of working owners were eligible to participate in tax-qualified retirement plans. When Congress enacted ERISA in 1974, it did not alter that basic principle. On the contrary, ERISA modified certain existing tax provisions to "grant[] self-employed people tax treatment with respect to retirement plans (H.R. 10 plans) which is more nearly comparable to that now accorded to corporate employees under qualified retirement plans." H.R. Rep. No. 807, 93d Cong., 2d Sess. 33 (1974). Moreover, as the many cross-references to the Internal Revenue Code in Title I of ERISA demonstrate, see pp. 14-16, *supra*, Congress sought to integrate the new statutory provisions with the existing tax provisions. The conclusion that working owners may be participants in plans covered by Title I—just as they may continue to participate in plans receiving favorable tax treatment under the Code provisions amended by Title II—accords with Congress's intent to create an integrated federal legislative scheme governing employee benefit plans.

### D. Treating Working Owners As Eligible Participants Advances The Purposes Of ERISA

1. The purposes of ERISA are furthered by allowing working owners to enjoy the benefits of Title I of ERISA, as well as the tax benefits provided by the Internal Revenue

Code and the termination insurance provided by Title IV of ERISA. In enacting ERISA, Congress recognized that employee benefit plans affect the well-being and security of millions of individuals and play an important role in stabilizing employment and industrial relations. 29 U.S.C. 1001(a). Congress therefore sought to protect the interests of participants in employee benefit plans and their beneficiaries, 29 U.S.C. 1001(b) and (c), and, as explained in later amendments to ERISA, to promote the development of such plans, 29 U.S.C. 1001a, 1001b. According working owners "participant" status under ERISA not only allows the owners themselves to enjoy the full panoply of protections provided by ERISA, but also promotes and strengthens the benefit rights of other employees.

The opportunity to participate in a benefit plan with the firm's other employees sometimes encourages working owners to establish a plan for those employees in the first instance.[10] Once a plan is established, participation by working owners as well as other employees may serve to increase scrutiny of the plan's administration, reduce administrative costs, and provide economies of scale in plan administration and investments. The owner's ability to enforce ERISA may also benefit the plan as a whole—for example, if the owner brings an action against a plan investment manager or insurance company for breach of fiduciary duty to the plan. See 29 U.S.C. 1132(a)(2) and (3) (standing); 29

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[10] In 2000, 65% of full-time employees at establishments with 100 or more employees were covered by pension plans, but only 33% of full-time employees at smaller establishments had pension coverage. Bureau of Labor Statistics, U.S. Dep't of Labor, No. 02-389, *Employee Benefits in Private Industry, 2000* (July 16, 2002). A recent survey of companies with five to 100 employees indicates that one factor influencing their decision to establish a pension plan is "so key executives can save for retirement on a tax-deferred basis." Employee Benefit Research Institute, *The 2003 Small Employer Retirement Survey (SERS) Summary of Findings* (June 3, 2003) <www.ebri.org/sers/2003/03sersof.pdf>.

U.S.C. 1104, 1106 (fiduciary duties); 29 U.S.C. 1002(21) (definition of fiduciary).

2. Defining the term "participant" in Title I to exclude working owners would lead to irrational consequences in the administration of employee benefit plans, because individuals covered by a single benefit plan would have different rights and remedies. For example, in one frequently-litigated scenario, the working owner of a small business purchases health or disability insurance for himself and his employees, and later sues the insurer for denying the owner's personal benefit claim.[11] In those cases, the owner typically seeks remedies under state law; the insurer argues that ERISA preempts the state-law remedies because they "relate to" an ERISA plan, 29 U.S.C. 1144(a); and the owner counters that there is no preemption because he cannot be a participant in an ERISA plan. Courts, such as the Sixth Circuit, that adhere to the view that working owners cannot be ERISA participants have concluded that the owner retains state-law remedies, even though other employees are limited to what are sometimes narrower remedies under ERISA. See, *e.g.*, *Fugarino*, 969 F.2d at 186.

The conclusion of those courts that the owner retains state-law remedies follows from application of the general view of ERISA preemption currently held by most courts of appeals, which is that a dispute between persons who are not acting in an ERISA capacity does not "relate to" a plan within the meaning of 29 U.S.C. 1144(a). See, *e.g.*, *LeBlanc* v. *Cahill*, 153 F.3d 134, 147 (4th Cir. 1998); *Arizona State Carpenters Pension Trust Fund* v. *Citibank*, 125 F.3d 715,

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[11] See, *e.g.*, *Gilbert* v. *Alta Health & Life Ins. Co.*, 276 F.3d 1292 (11th Cir. 2001); *Agrawal*, *supra*; *Vega*, *supra*; *Wolk* v. *UNUM Life Ins. of Am.*, 186 F.3d 352 (3d Cir. 1999), cert. denied, 528 U.S. 1076 (2000); *Robinson* v. *Linomaz*, 58 F.3d 365 (8th Cir. 1995); *Peterson* v. *American Life & Health Ins. Co.*, 48 F.3d 404 (9th Cir.), cert. denied, 516 U.S. 942 (1995); *Madonia*, *supra*; *Fugarino*, *supra*.

723-724 (9th Cir. 1997); *Sommers Drug Stores Co. Employee Profit Sharing Trust* v. *Corrigan Enters.*, 793 F.2d 1456, 1467-1468 (5th Cir. 1986), cert. denied, 479 U.S. 1034 (1987). There is, however, a contrary argument that benefit claims by working owners do "relate to" an ERISA plan because they are based on an insurance contract or other document that is an ERISA plan because it also covers non-owner employees. But that approach would still result in different rights and remedies for individuals covered by a single plan. The owners would have no remedy at all—under either ERISA or state law—while non-owner employees would continue to have the remedies provided by ERISA.

The anomalous situation in which individuals covered by the same plan have different rights and remedies undermines two related purposes of ERISA: to "ensure[] that the administrative practices of a benefit plan will be governed by only a single set of regulations," *Fort Halifax Packing Co.* v. *Coyne*, 482 U.S. 1, 11 (1987), and to "ensure[] similar treatment for all claims relating to employee benefit plans," *Madonia*, 11 F.3d at 450.

The same problem arises in situations, such as the one presented by this case, in which the owner seeks to be recognized as an ERISA participant to gain protections that the owner contends are provided by ERISA—here the protection against alienation of pension benefits. See, *e.g.*, *Kwatcher* v. *Massachusetts Serv. Employees Pension Fund*, 879 F.2d 957 (1st Cir. 1989) (sole shareholder suing for benefits from multi-employer plan to which he had previously contributed). In those contexts as well, the Sixth Circuit's rule would lead to the anomalous result that individuals covered by a single plan have different rights and remedies. Those anomalies would occur in a substantial number of plans, because many working owners are already included in plans that are covered by ERISA for other employees, see p. 10 and notes 4-5, *supra*, and because there are strong tax

incentives for working owners to participate in plans that also cover other employees, see 26 U.S.C. 401, 402, 404, 410(b), 501(a).

Moreover, to the extent that the decisions holding that working owners are not ERISA plan participants stand for the proposition that the plans themselves have two separate components, one covered by ERISA and the other not covered, the result is even more unworkable. Under the Internal Revenue Code, a pension plan is either tax-qualified or it is not; it is not meaningful to describe a plan as tax-qualified in part. The same is true under Title I of ERISA. Title I requirements, such as the duty to hold plan assets in trust and to manage those assets in accordance with ERISA fiduciary duties, apply to all the assets of the plan. Indeed, in traditional defined-benefit plans, in which plan assets are not held in individual accounts, it is impossible to apply ERISA fiduciary duties to only that portion of plan assets earmarked for employees other than working owners. Although it would be theoretically possible to hold that Title I of ERISA precludes working owners from even being covered by plans that cover non-owner employees, such a holding would put Title I of ERISA at war with the Internal Revenue Code as amended by Title II of ERISA, which not only allows but encourages joint participation.

3. A number of courts have tried to avoid treating working owners and their employees differently under ERISA by covering the owners as "beneficiar[ies]" under 29 U.S.C. 1002(8) rather than "participant[s]" under 29 U.S.C. 1002(7).[12] Those courts have reasoned that ERISA's definition of beneficiary is broad enough on its face to encompass working owners because it includes any "person designated * * * by the terms of an employee benefit plan[] who is or

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[12] See, *e.g.*, *Gilbert*, *Wolk*, *Robinson*, *Peterson*, *supra*; *Harper* v. *American Chambers Life Ins. Co.*, 898 F.2d 1432 (9th Cir. 1990).

may become entitled to a benefit" under the plan. 29 U.S.C. 1002(8); see, *e.g.*, *Harper* v. *American Chambers Life Ins. Co.*, 898 F.2d 1432, 1434 (9th Cir. 1990).

That approach, however, has two fundamental flaws. First, it has no logical stopping point: anyone could be "designated * * * by the terms of an employee benefit plan" as a beneficiary, even when that person lacks any employment nexus with the plan sponsor. For instance, in *Hollis* v. *Provident Life & Accident Insurance Co.*, 259 F.3d 410, 415 (5th Cir. 2001), cert. denied, 535 U.S. 986 (2002), the court held that an independent contractor could be designated as a "beneficiary" under an ERISA plan, a result that is in considerable tension with this Court's decision in *Darden* that an independent contractor cannot be a plan "participant."

Second, the "beneficiary" theory would enable working owners to earn benefits only under welfare plans, and not under pension plans, because the ERISA provisions that create pension rights generally use the terms "employee" and "participant," not the term "beneficiary." See, *e.g.*, 29 U.S.C. 1002(2)(A), 1052, 1053. Although a participant in a pension plan may *have* a beneficiary, such as a surviving spouse, pension credits can only be earned on work performed by an employee; the entitlement of the beneficiary is purely derivative. See 29 U.S.C. 1055; *Boggs* v. *Boggs*, 520 U.S. 833, 846-847 (1997). Thus, a broad interpretation of "beneficiary" to include working owners cannot correct the anomalous results produced by an overly constricted interpretation of "participant" that excludes working owners.

### E. The Department Of Labor Interprets ERISA To Permit Working Owners To Be ERISA Plan Participants

Based on the above considerations, the Department of Labor has concluded in an advisory opinion that working owners may be "participants" in ERISA plans. See Pension & Welfare Benefits Admin., U.S. Dep't of Labor, Advisory

Opinion No. 99-04A (Feb. 4, 1999) (*reprinted in* App., *infra*, 1a-9a). The opinion carefully reviews the various provisions of ERISA discussed at pages 14-18 above, and concludes that, taken as a whole, they "reveal a clear Congressional design to include 'working owners' within the definition of 'participant' for purposes of Title I of ERISA." App., *infra*, 5a. The opinion further reasons that Congress would not have barred working owners from eligibility to participate in plans covered by Title I when it has long been established that they may participate in plans that qualify for favorable tax treatment under Title II and it is clear that they may participate in plans that qualify for termination insurance under Title IV. *Id.* at 7a-8a. As the considered view of the agency charged by Congress with the administration and enforcement of Title I of ERISA, the Department's advisory opinion reflects a "body of experience and informed judgment to which courts and litigants may properly resort for guidance." *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944).

Although petitioners alerted the Sixth Circuit to the advisory opinion, the court did not discuss it. Instead, the court followed its own prior decisions in *Fugarino* and *Agrawal*, which had held that sole proprietors and sole shareholders may not be ERISA plan participants. See Pet. App. 5a-6a. The Sixth Circuit reached that result in those cases, however, based in large part on its misinterpretation of a Department of Labor regulation, 29 C.F.R. 2510.3-3(c)(1). See *Fugarino*, 969 F.2d at 185-186; *Agrawal*, 205 F.3d at 302-303 (following *Fugarino* but implying that *Fugarino* misread the regulation). The Sixth Circuit, like other courts of appeals that have held that sole proprietors and sole shareholders may not be ERISA plan participants, mistakenly read the regulation as providing a general definition of the statutory term "employee" that excludes sole shareholders, thereby precluding them from being plan

participants. See 969 F.2d at 185-186; *Kwatcher*, 879 F.2d at 961-962; *Giardono* v. *Jones*, 867 F.2d 409, 412 (7th Cir. 1989).

Contrary to that reading, as explained by the courts of appeals that have held that sole shareholders may be plan participants, the regulation does not define the statutory term "employee." Nor does it identify who is eligible to be a "participant" in a plan covered by Title I of ERISA. Rather, the regulation addresses what plans are covered by Title I of ERISA in the first place. See *Vega*, 188 F.3d at 294; *Madonia*, 11 F.3d at 449-450; see also *Gilbert* v. *Alta Health & Life Ins. Co.*, 276 F.3d 1292, 1302-1303 (11th Cir. 2001).

The regulation as a whole is entitled "[e]mployee benefit plan," and its numbering, Section 2510.3-3, corresponds to Section 3(3) of ERISA, 29 U.S.C. 1002(3), the statutory definition of the term "employee benefit plan." Subsection (a) of the regulation explains its scope: it "clarifies the definition in section 3(3) of the term 'employee benefit plan' for purposes of title I of the Act." 29 C.F.R. 2510.3-3(a). Subsection (b) of the regulation, entitled "[p]lans without employees," provides that "the term 'employee benefit plan' shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan." 29 C.F.R. 2510.3-3(b). Subsection (b) explains, for example, that, although a "Keogh" or "H.R. 10" plan covering only partners or a sole proprietor will not be covered under Title I, "a Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under title I." 29 C.F.R. 2510.3-3(b). Subsection (c) of the regulation is entitled "Employees" and states:

> For purposes of this section [*i.e.*, for purposes of the regulation defining a covered plan]:

> (1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and
>
> (2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

29 C.F.R. 2510.3-3(c)(1) and (2).

The regulation thus excludes from Title I coverage plans whose *only* participants are sole owners or partners and their spouses. Subsection (c) identifies who shall not be deemed an "employee" only for purposes of the regulation itself, which defines covered "plans," not covered "participants." Subsection (c) does not exclude sole owners or partners from the *statutory* definition of "employee" or from being participants in plans that also cover one or more employees who are not sole owners or partners and their spouses. As the Department of Labor explains in its advisory opinion, the regulation is thus fully consistent with the Department's view that working owners may be "participants" in ERISA plans. See App., *infra*, 8a n.7.[13]

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[13] The fact that the regulation does not provide a general definition of "employee" was made even more explicit in the regulatory preamble. The preamble explained that, in the proposed rule, the definition of "employee" had been located in 29 C.F.R. 2510.3-6, a provision whose numbering corresponded to Section 3(6) of ERISA, 29 U.S.C. 1002(6), the definition of "employee." Thus, the proposed rule had defined "employee" for all purposes under Title I. Comments on the proposed rule, however, raised concerns that the definition might preclude plans from paying benefits to self-employed individuals in plans that also covered other employees. In response, "the definition of 'employee' formerly appearing in proposed § 2510.3-6 [was] inserted into § 2510.3-3 and restricted in scope to that section." 40 Fed. Reg. 34,528 (1975).

### F. Plan Participation By Working Owners Does Not Violate ERISA's Anti-Inurement Provision

The courts of appeals that have denied participant status to working owners have also mistakenly relied on ERISA's "anti-inurement" provision, 29 U.S.C. 1103(c)(1), which prohibits the assets of ERISA plans from inuring to the benefit of employers. That provision, those courts have reasoned, is transgressed if an owner is also a plan participant because then the owner, as a participant, may benefit from plan assets. See *Fugarino*, 969 F.2d at 186; *Kwatcher*, 879 F.2d at 959-960; *Giardono*, 867 F.2d at 411. The anti-inurement provision, however, does not preclude coverage of working owners as plan participants. It states that, with enumerated exceptions, "the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan." 29 U.S.C. 1103(c)(1). Accordingly, the provision expressly permits the payment of benefits to plan participants, and it does not address the separate question whether working owners may be participants.

Indeed, the anti-inurement provision in Title I of ERISA is based on the analogous exclusive benefit provision in the Internal Revenue Code, 26 U.S.C. 401(a)(2), which has never been understood to bar plan participation by working owners. See H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 302-303 (1974); pp. 16-17, 19-20, *supra*. The purpose of the anti-inurement provision, like ERISA's other fiduciary responsibility provisions, is to apply the law of trusts to discourage abuses such as self-dealing, imprudent investment, and misappropriation of plan assets, by employers and others. See, *e.g.*, *Prudential Ins. Co. of Am.* v. *Doe*, 76 F.3d 206, 209 (8th Cir. 1996). Those concerns are not implicated by paying benefits to working owners who participate on an equal basis in plans protected by other ERISA safeguards.

## CONCLUSION

The judgment of the court of appeals should be reversed, and the case remanded for further proceedings, including resolution of the question whether respondent may set aside Dr. Yates' loan repayment to the plan as a preferential transfer under 11 U.S.C. 547(b) even though Dr. Yates' interest in the plan is excluded from the bankruptcy estate because it is protected by ERISA's anti-alienation provision, 29 U.S.C. 1056(d).

Respectfully submitted.

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AUGUST 2003

**APPENDIX**

**U.S. Department of Labor**

Pension and Welfare Benefits Administration
Washington, D.C. 20210

[seal omitted]

Feb. 4, 1999

John P. Counts, Esq.
David Potts-Dupre, Esq.
Counts & Kanne
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99-04A
ERISA SEC.
3(7)

Dear Messrs. Counts and Potts-Dupre:

This is in response to your request for an advisory opinion containing the definition of "participant" provided in section 3(7) of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Specifically, you ask whether individuals who own business enterprises, either wholly or in part, and who provide personal services to those businesses may be "participants," within the meaning of section 3(7) of ERISA, in a multiemployer employee benefit plan. You state that the business enterprises that are the subject of this request include businesses that are operated as corporations, sole proprietorships, and partnerships.

You submit your request on behalf of the National Electrical Benefit Fund (the NEBF), a multiemployer pension plan established jointly by the International Brotherhood of Electrical Workers (IBEW) and the National Electrical Contractors Association (NECA) pursuant to collective bar-

gaining. You describe the NEBF as the largest construction industry fund in the United States, with approximately 375,000 participants, over 14,000 contributing employers, and plan assets of almost five billion dollars.

The documents that you have submitted indicate that an individual can become eligible to participate in the NEBF only as a result of an employer's having executed a participation agreement with the NEBF, obligating the employer to make contributions on behalf of at least some of its employees. *See* Restated Employees Benefit Agreement and Trust for the National Electrical Benefit Fund (hereinafter Trust Agreement), Part I, Provision 4; sections 1.7, 1.8, 1.18, 6.3.3. An employer must agree at a minimum to make contributions on behalf of its bargaining unit employees. *Id.* section 6.3.1. Such an employer may elect, in addition, to contribute on behalf of its "non-bargaining unit employees." An employer may contribute on behalf of all "non-bargaining unit employees" or only those non-bargaining unit employees who were formerly bargaining unit members ("alumni"). *Id.*

With respect to bargaining unit employees, a participating employer must contribute to the NEBF an amount equal to three percent of "all wages and other compensation paid to, or accrued by, the Covered Employees in the . . . bargaining unit for services performed for the Covered Employer." *Id.* section 6.2.1. For non-bargaining unit employees, the employer must contribute to the NEBF an amount equal to the lesser of

> "(a) 3% of all wages and other compensation which the Covered Employer would pay, or which the [non-bargaining unit] Covered Employees would accrue, if the Covered Employees were receiving the wage rate received by the highest number of employees in the appropriate . . . bargaining unit and working the

> normal straight time hours provided for in the appropriate labor agreement, or (b) 3% of all wages and other compensation paid to, or accrued by, the [non-bargaining unit] Covered Employees for services performed for the Covered Employer. . . ."

*Id*. Section 6.2.2.

The documents that you have supplied indicate that the NEBF provides a pension benefit, which may be paid as an early retirement pension or a normal retirement pension, and a disability benefit. A participant becomes vested in his or her pension benefit upon earning at least five vesting service credits.[1] Pension benefits for vested participants are calculated by multiplying the participant's benefit service credits[2] by fixed dollar amounts that are specified in the plan. As a result, the amount of a participant's monthly pension benefit is not dependent upon the participant's actual income prior to retirement or the actual amount of contributions that an employer made on his or her behalf, but rather upon seniority in the NEBF.

You represent that the trustees of the NEBF currently interpret its plan documents to permit "working owners"[3] to be treated as employees eligible to participate in the NEBF

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[1] One vesting service credit is earned for each year after 1965 in which a participant is credited with 1000 hours of covered service for covered employment (employment during a period for which an employer is obligated to make contributions for that employee).

[2] One benefit service credit is similarly earned for each year after 1965 in which a participant is credited with 1000 hours of covered employment.

[3] By the term "working owner," you apparently mean an individual who has an equity ownership right of any nature in a business enterprise and who is actively engaged in providing services to that business, as distinguished from a "passive" owner, who may own shares in a corporation, for example, but is not otherwise involved in the activities in which the business engages for profit.

and therefore to become participants in the NEBF.[4] The eligible "working owners" include any "owner that earns wages or self-employment income from a company," including sole proprietors of unincorporated businesses. You indicate that the working owners who currently participate in the NEBF are journeyman electricians who had worked initially as bargaining unit members for other employers that contributed to the NEBF on their behalf. They subsequently acquired ownership interests in those employers or started their own electrical businesses, sometimes in partnership with other similarly situated individuals, sometimes by creating wholly-owned corporations, and sometimes operating as sole proprietors. They continue to work as electricians and in some cases employ other union members covered by the NEBF. Most of these working owners had earned vested pension benefits in the NEBF based on their previous service as bargaining unit employees, and they began accruing additional service credits when the NEBF changed its eligibility rules in 1994 to permit working owners to participate.

You represent that the employer's payroll reports, submitted monthly to the NEBF, are used to determine an employer's contributions, based on the working owner's reported "wages," and a working owner's service credits, based on the working owner's reported hours of service. You further represent that reporting employers determine a working owner's "wages" by determining the greater of the working owner's actual gross earnings subject to employment tax for that month or the amount the working

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[4] This current practice has been followed only since January, 1994. In the course of its history (since its creation in the early 1960's), the NEBF's practices have varied regarding participation by individuals who have equity ownership rights in business enterprises that operate in the industry covered by the IBEW.

owner would have earned if he had worked at normal straight-time hours for the month at the applicable journeyman's rate. The working owner's hours of service are reported as the actual hours the working owner worked for the business during the month.

Section 3(7) of Title I of ERISA provides that a "participant" is "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit." Section 3(6) in turn defines an "employee" as "any individual employed by an employer." Finally, section 3(5) defines "employer" as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity."

Title I of ERISA contains multiple indications, albeit indirect, that Congress assumed that a "working owner" could be a "participant" in an employee benefit plan sponsored by the business in which that working owner held an ownership right, regardless of the legal form in which the business was operated. For example, section 401(a)(2) exempts certain partnership agreements from the fiduciary provisions of Part 4. This exemption would be meaningless if the partnership agreements themselves (which cover only partners, one of the categories of "working owners") were not otherwise plans covered by Title I. Further, section 403(b)(3)(A) specifically exempts from the trust requirement of section 403(a) a plan "some or all of the *participants* of which are employees described in section 401(c)(1) of the Code [emphasis added]." This exemption takes as its basis

the assumption that the employees described in Code section 401(c)(1), namely self-employed individuals (including "working owners"), are legitimate "participants" within the meaning of Title I. Also, section 408(b)(1) exempts from section 406's prohibition of specified transactions certain nondiscriminatory loans made to plan participants, including highly compensated employees, but section 408(d)(1) eliminates that exemption for owner-employees as defined in section 401(c)(3) of the Code. Inasmuch as the owner-employers described in Code section 401(c)(3) are sole proprietors and more than ten-percent partners, it is clear that the provisions in section 408 of Title I assume that such "working owners" are "participants" in the plans from which those loans would be made.

The indications of Congressional intent are supported and reinforced by the treatment of "working owners" under the provisions of Title II and Title IV of ERISA.[5] Section 401(c) of the Internal Revenue Code (the Code) provides that self-employed individuals are included as "employees" under Code section 401(a) to the extent that they have earned income "with respect to a trade or business in which personal services of the [individual] are a material income-producing factor." Code section 401(c)(2)(A). Code section 401(c) further imposes specific additional requirements on tax-qualified pension plans that provide benefits to "owner-employees," a term defined in Code section 401(c)(3) to include employees who own the entire interest in an unincorporated trade or business or more than 10 percent of a partnership. It is thus patently clear that Title II of ERISA

[5] Although we rely on certain provisions of Title II and Title IV in reaching the conclusions expressed in this opinion, nothing in this opinion should be construed as interpreting the provisions of those Titles that lie within the interpretive jurisdiction of the Department of the Treasury and the Pension Benefit Guaranty Corporation.

permits "working owners" to receive the tax benefits that flow from participation as "participants" in pension plans that meet the qualification requirements of Code section 401(a).

Title IV of ERISA (the termination insurance provisions) also expressly includes "working owners" among the "participants" who receive its protections. *See* ERISA section 4001(b)(1) ("[a]n individual who owns the entire interest in an unincorporated trade or business is treated as his own employer, and a partnership is treated as the employer of each partner who is an employee within the meaning of [Code] section 401(c)(1). . ."). Section 4021(b)(9) of ERISA excludes from coverage under Title IV only those pension plans that are "established and maintained exclusively for substantial owners," i.e., sole proprietors and more than ten-percent owners of partnerships and corporations. *See* ERISA section 4022(b)(5)(A) (defining "substantial owner"). Title IV limits the amount of benefits that the PBGC guarantees to "substantial owners" who participate in single employer plans, but nonetheless provides a basic guarantee of such owners' pension benefits. Such a guarantee would be meaningless if Title I did not permit such owners to be participants in ERISA-covered pension plans.

In our view, the statutory provisions of ERISA, taken as a whole, reveal a clear Congressional design to include "working owners" within the definition of "participant" for purposes of Title I of ERISA. Congress could not have intended that a pension plan operated so as to satisfy the complex tax qualification rules applicable to benefits provided to "owner-employees" under the provisions of Title II of ERISA, and with respect to which an employer faithfully makes the premium payments required to protect the benefits payable under the plan to such individuals under Title IV of ERISA, would somehow transgress against the

limitations of the definitions contained in Title I of ERISA. Such a result would cause an intolerable conflict between the separate titles of ERISA, leading to the sort of "absurd results" that the Supreme Court warned against in *Nationwide Mutual Insurance Co.* v. *Darden*, 503 U.S. 318 (1992).[6]

Therefore, it is the view of the Department that there is nothing in the definitions of Title I of ERISA that would preclude a pension plan, including the NEBF, from extending plan coverage to "working owners," as described in your submission, where such coverage is otherwise consistent with the documents and instruments governing the plan and does not violate any other provisions of Title I.[7]

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[6] In *Darden*, the United States Supreme Court held that the definition of "employee" provided in section 3(6) of Title I did not include an individual who was an independent contractor to the employer that established and maintained the plan. In reaching this conclusion, the Court first sought to determine whether ERISA contained any provision "either giving specific guidance on the term's meaning or suggesting that construing it to incorporate traditional agency law principles would thwart the congressional design or lead to absurd results." *Id.* at 323. Finding no guidance in the statute itself, the Court concluded that, "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." 503 U.S. at 322. We follow here the Court's analysis in *Darden*, although with a different result, inasmuch as we find ample guidance in ERISA as to Congress' specific intent to treat "working owners" as "participants."

[7] In its regulation at 29 C.F.R. 2510.3-3, the Department clarified that the term "employee benefit plan" as defined in section 3(3) of Title I does not include a plan the only participants of which are "[a]n individual and his or her spouse . . . with respect to a trade of business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse" or "[a] partner in a partnership and his or her spouse." The regulation further specifies, however, that a plan that covers as participants "one or more common law employees, in addition to the self-employed individuals" will be included in the definition of "employee benefit plan" under section 3(3). The conclusion of this opinion, that such "self-employed individuals" are themselves "participants" in the covered plan, is fully consistent with that regulation.

ERISA's fiduciary standards, however, require compliance with any other applicable federal law. Pursuant to ERISA section 514(d), nothing in Title I of ERISA shall be construed to alter, amend, modify, invalidate, impair, or supersede any federal law or any rule or regulation issued pursuant to such federal law. Such federal laws include any requirements applicable to multiemployer benefit plans under the Labor Management Relations Act (LMRA). Several federal courts interpreting the LMRA have upheld decisions by plan trustees to exclude owner-employees on the ground that their inclusion would violate the LMRA. *See*, *e.g.*, *Todd* v. *Benal Concrete Const. Co., Inc.*, 710 F.2d 581 (9th Cir. 1983); *Aitken* v. *GCU-Employer Retirement Fund*, 604 F.2d 1261 (9th Cir. 1979). The Department is not authorized to issue opinions regarding the LMRA. Accordingly, the fiduciary of a plan subject to the LMRA that includes "working owners" should seek legal advice regarding the propriety of the participation of "working owners" in such plans under the LMRA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, it is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

Susan G. Lahne
Acting Chief
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Interpretations
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